In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 737

THE MARYLAND JOCKEY CLUB OF BALTIMORE CITY,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 5-16) is reported in 118 F. Supp. 349. The opinion of the Court of Appeals (R. 65-72) is reported in 210 F. 2d 367.

JURISDICTION

The judgment of the Court of Appeals was entered on February 3, 1954. (R. 72.) The petition for certiorari was filed on April 29, 1954. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether certain sums deducted pursuant to state law by the taxpayer, a race track operator, from amounts taken in by it at its pari-mutuel windows, which sums were paid by it into a special account known as the "Racing Fund" and then released by the State Racing Commission to the taxpayer in a later year as reimbursement for expenditures involved in rebuilding its racing strip, constituted taxable income to the taxpayer in the year of release within the meaning of Section 22(a) of the Internal Revenue Code.

STATUTES INVOLVED

The pertinent statutes are set forth in an Appendix, *infra*, pp. 12-15.

STATEMENT

The facts, all of which were either stipulated or were established by undisputed documentary evidence, may be summarized as follows:

The taxpayer is a Maryland corporation which operated a race track at Pimlico Race Course, Baltimore, Maryland, where horse racing was conducted and pari-mutuel betting carried on under the laws of Maryland. During the years involved the taxpayer's principal income was derived from admission fees and its share of pari-mutuel bets allowed by law in the operation of its race track. (R. 16.) The taxpayer kept its books and filed its income tax returns on the cash basis and on the basis of fiscal years ended November 30th. (R. 17.)

In July, 1938, the State Racing Commission authorized race tracks in Maryland to take an addi-

tional 1% of the mutuel pool to be used for improving race tracks, making needed plant improvements and the promotion of livestock breeding. (Stip. Ex. H, R. 24-25.)

From 1938 to 1944, no accounting was required of the tracks by the Racing Commission with respect to the spending of the extra 1% above-mentioned, although the Racing Commission sometimes gave general approval to the same. (Plft. Ex. B, R. 48, 49.)

In April 1944, the Racing Commission adopted a series of resolutions the final result of which was to divide the additional 1% equally between a fund for purses and the "Racing Fund", it being provided that ½ of 1% representing the "Racing Fund" was to be held in the fund until the 1945 Regular Session of the General Assembly of the State of Maryland and pending its action authorizing the disposition of the fund under the supervision of the Maryland Racing Commission. (Stip. Ex. L, R. 44-45.)

In the Regular Session of the General Assembly of the State of Maryland for the year 1945, the State Legislature provided for the disposition of the fund (Flack, Annotated Code of Maryland (1947 Cum. Supp.), Article 78B); that for the calendar year 1947 and each year thereafter, each track as agent for the Commission should deduct ½ of 1% of amounts wagered and remit the amounts deducted to the Commission, this sum to comprise a fund known as the "Racing Fund" which should be deposited by the Commission in one or more

banks in the State. The amount of the "Racing Fund" on hand at any time representing deductions made by any particular track might with the prior written and express permission of the Commission and on such terms and conditions as the Commission might prescribe, be expended by that particular track for "any substantial alterations, additions, changes, improvements, or repairs" to or upon the property owned or leased by the track and by it used in the conduct of racing. (R. 50.) If the deductions provided for and made by the track were neither spent nor binding commitments for their expenditure made with the approval of the Commission within three years from the last day of the year of collection, the unspent portion would revert to the State as part of its general funds and would be paid over promptly by the Commission to the Comptroller.[1] (R. 50-51.)

For the fiscal years ended November 30, 1944, to November 30, 1948, the taxpayer deducted as agent for the Maryland Racing Commission from money wagered at its track the total sum of $624,584.27, and remitted such deductions to the Commission which deposited the money to its order in a bank selected by it in accordance with the resolutions of the Commission and the statutory law of the State of Maryland. (R. 18.) In its income tax returns

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[1] An escape clause was provided extending the time for expenditures of amounts collected in 1944 and 1945 up to December 31, 1949, when war conditions prevented expenditures sooner, and the time was further extended by Chapter 502, Laws of 1947, as to collections for 1944, 1945 and 1946, up to December 31, 1950.

the amounts paid to the Commission were deducted from its receipts (R. 18-19).

After the fall meeting of 1947 and the spring meeting of 1948 held by the taxpayer at its race track, due to heavy rains, it was necessary for taxpayer to make expenditures in rebuilding its racing strip. At the end of the spring meeting in 1948, the officers of the taxpayer decided to rebuild its racing strip as a substantial addition and improvement upon its racing property. (R. 21.)

On July 28, 1948, the taxpayer notified the Racing Commission that it proposed to rebuild its racing strip and thereafter, and during the fiscal year ended November 30, 1948, the Racing Commission gave its written and express permission to the taxpayer with respect thereto. Work on this project was begun and completed before the end of the fiscal year ended November 30, 1948, at a cost of $75,608.66. (R. 21.)

On November 24, 1948, the taxpayer forwarded its bills and invoices showing the performance of the work and furnishing of the materials including the cost thereof in connection with the rebuilding of the strip, together with payments thereof to the Maryland Racing Commission, and on November 29, 1948, the taxpayer received from the Commission, out of the funds deducted and deposited in the "Racing Fund" with the Commission by the taxpayer, a check for $75,608.66, as reimbursement for the expenditures made in rebuilding the racing strip. (R. 21-22.)

In its income tax return for the year ended No-

vember 30, 1948, the taxpayer included as income the sum of $75,608.66, as representing "withdrawal from Maryland Racing Commission Fund." (R. 17.) It later filed a claim for refund for $28,731.29, the tax attributable to this sum, alleging that (R. 17-18) the sum was erroneously included in its gross income. The claim was disallowed by the Commissioner. (R. 18.)

The taxpayer then brought this action to recover $28,731.29, plus interest, income taxes for the fiscal year ended November 30, 1948. (R. 65-66.) The District Court held that the Commissioner of Internal Revenue had erroneously included in the taxpayer's income for the year involved the sum of $75,608.66, and that consequently the taxpayer was entitled to recover the entire amount sued for in its complaint. (R. 5-6.) The decision of the District Court was reversed by the Court of Appeals. (R. 65-72.)

ARGUMENT

1. The sum of $75,608.66 paid to the taxpayer during November of 1948 by the Maryland Racing Commission out of the so-called "Racing Fund" was properly included in the taxpayer's income under the broad provisions of Section 22(a), Internal Revenue Code, Appendix, *infra*, p. 12. It was derived from pari-mutuel earnings of the taxpayer realized through the operation of its track. While it was required under state law to be set aside in a special fund subject to the control of the Racing Commission and there held in an account earmarked for the taxpayer's future use, it could be

released to the taxpayer for its use in making substantial alterations, additions, improvements, or repairs to its track, if reasonably needed, within three years from the date set aside. The sum did not and could not become part of the general funds of the State until after the expiration of the three year period. Flack, Annotated Code of Maryland (1947 Cum. Supp.), Article 78B, Appendix *infra*, pp. 12-15.

Since the sum was derived from labor and capital of the taxpayer, since it never unqualifiedly vested in the State and was released unconditionally and irrevocably to the taxpayer as a reimbursement for additions and improvements made to its track and since it was received by the taxpayer in the fiscal year ended November 30, 1948, without restriction and under a claim of right, it was clearly taxable income in that year.[2]

There is nothing in the provisions of the Annotated Code of Maryland as amended in 1951 and 1953, which supports the taxpayer's position here. The amendment of 1951 (Section 12, Article 78B (1951 Supp.) (Pet. 20-23)), does not substantially change the provisions of Section 12, Article 78B (1947 Cum. Supp.), Appendix, *infra*, pp. 13-15, which was in effect in the year involved, except that Section 12(a) of the amended statute refers to the amounts paid to the Maryland Racing Commission for the use of the State as a tax. It is provided, however, in Section 12(b) of the amended statute

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[2] *Eisner* v. *Macomber*, 252 U.S. 189; *North American Oil* v. *Burnet*, 286 U.S. 417; *United States* v. *Lewis*, 340 U.S. 590; *Mutual Tel. Co.* v. *United States*, 204 F. 2d 160 (C.A. 9th).

that the Commission is not required to remit any part of the "Racing Fund" to the Comptroller or Treasurer of the State unless and until the fund reverts to the General Treasury in the manner provided in Subsection (c) of the amended statute which in turn provides that the sum shall not revert to the State until elapse of the three year period.[3] Furthermore, the amendment of Section 12 by the addition of subsection (e) in 1953 (Pet. 23-24) had the effect of clarifying the law as it existed in 1948 as to the powers of the Maryland Racing Commission in making commitments and grants for expenditures previously made with respect to alterations, additions, changes and improvements on race tracks. It has little or no bearing on the issue here involved.

2. There is no conflict in decisions requiring resolution by this Court.

Despite the taxpayer's assertion (Pet. 13-14) that the instant decision is contrary to the principles enunciated by this Court in *Edwards* v. *Cuba*

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[3] The taxpayer's returns for the fiscal years 1944 to 1947, inclusive (Stip. Ex. D, E, F, G, R. 20) disclose that the taxpayer deducted the amounts paid to the Racing Commission in those years in determining its gross receipts and received tax benefits as a consequence. (R. 18-19.) Even if the sums had been collected by the State as a tax under the provisions of the 1951 amendment but had later been refunded to the taxpayer, they would have constituted income in the year received under the tax benefit rule. Section 22(b)(12), Internal Revenue Code, as added by Section 116 of the Revenue Act of 1942, c. 619, 56 Stat. 798; *Union Trust Co.* v. *Commissioner*, 111 F. 2d 60 (C.A. 7th), certiorari denied, 311 U.S. 658; *Electric Storage Battery Co.* v. *Rothensies*, 152 F. 2d 521 (C.A. 3d), affirmed on this point but reversed on other grounds, 329 U.S. 296; Section 12, Article 78B of the Annotated Code of Maryland, as amended (1951 Supp.) *supra*.

Railroad Company, 268 U.S. 628, it is apparent that the latter case is clearly distinguishable. In the *Cuba Railroad* case, it was decided that subsidy payments to that taxpayer by the Cuban Government out of its own treasury for the construction of a railroad were not made for services rendered or to be rendered and were not profits or gains from the use or operation of the railroad and consequently were not taxable income under the Sixteenth Amendment and statutes then in force defining income. Here, on the other hand, the funds in question were earned by the taxpayer, never became part of the general funds of the State, were held in a special account for the taxpayer's use, and finally did not in a true sense represent a governmental subsidy.[4]

Likewise, *Decatur Water Supply Co.* v. *Commissioner*, 88 F. 2d 341 (C.A. 7th), also cited by taxpayer as a contrary authority (Pet. 15-16), is clearly distinguishable. There the city created the taxpayer corporation to finance an addition to the City Water Works System. The court held that, under the peculiar facts involved, income from the operation of the water system was the income of the city rather than the taxpayer and that a percentage of the income which was to be paid to the taxpayer

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[4] Even if these funds had vested in the State and were later distributed to the taxpayer out of the State's general funds as a grant or subsidy to aid the taxpayer in the operation of its race track, the sums would undoubtedly be taxable income in the year received by the taxpayer. *Baboquivari Cattle Co.* v. *Commissioner*, 135 F. 2d 114 (C.A. 9th); *Lykes Bros. S. S. Co.* v. *Commissioner*, 126 F. 2d 725 (C.A. 5th), *Helvering* v. *Claiborne-Annapolis Ferry Co.*, 93 F. 2d 875 (C.A. 4th).

by the city under a contract, which was derived from net water rents, was received by the taxpayer as a conduit for its preferred stockholders because of provisions in the contract requiring that it be earmarked for the stockholders' use. The situation there was vastly different from that in the case at bar.

Although the taxpayer seems to contend to the contrary (Pet. 12-13), an opinion by the Attorney General for the State of Maryland on the taxability of the fund for state tax purposes would not of course be controlling in resolving the instant problem. However, there is nothing in the opinions of the State Attorney General which have been introduced in evidence which is contrary to the position we have taken here.[5]

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[5] Taxpayer's Exhibit A (R. 47) is a ruling by the State Attorney General in June, 1944, to the effect that race tracks did not derive income for state tax purposes through the initial collection of the amounts deposited with the Racing Commission for the reason that the sum was required to be held pending its disposition by action of the 1945 Maryland Legislature. The question here relates to its taxability in the year when the fund was later released, and not as to the year of its initial collection. On the other hand, the taxpayer's Exhibit B (R. 48), was a ruling by the State Attorney General of May 1950, on the question of whether this taxpayer was entitled to be reimbursed for expenditures made without approval of the Commission. While the Attorney General did not rule on the specific question here involved he did state (R. 50): "When, however, any part of the fund was released by the Commission to the track, it might be taxable income. If it reverted to the State, it never became subject to Federal Income Tax".

CONCLUSION

The decision below is correct. There is no conflict. The petition for certiorari should accordingly be denied.

Respectfully submitted,

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MAY, 1954.

APPENDIX

Internal Revenue Code:

SEC. 22 [as amended by Section 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574]. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 22.)

Flack, Annotated Code of Maryland (1947 Cum. Supp.):

ARTICLE 78B.

1. There shall be a Maryland Racing Commission, and the same is hereby created and established, which said Maryland Racing Commission shall be vested with and possessed of the powers and duties in this Article specified and also the powers necessary or proper to enable it to carry out fully and effectually all the

purposes of this Article. The jurisdiction, supervision, powers and duties of the Maryland Racing Commission herein created and established shall extend under this Article to any and all person or persons, associations or corporations which shall hereafter hold or conduct any meeting within the State of Maryland whereat horse racing shall be permitted for any stake, purse or reward.

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11. Said Racing Commission shall have full power to prescribe rules, regulations and conditions under which all horseraces shall be conducted within the State of Maryland. Said Commission may make rules governing, restricting or regulating betting on such races and may fix, regulate and condition the rate of charge of the licensee for admission, or for the performance of any service, or for the sale of any article on the premises of such licensee, and may regulate the size of the purse, stake or reward to be offered for the conduct of such races. Each licensee may deduct and retain for its own account one-half (½) of the breakage computed to the 10¢ and 6% of the mutuel pool, including any deduction required by the Commission as its agent pursuant to the provisions of Section 12 of this Article but exclusive of the 4% State tax imposed by Section 14 of this Article. * * *

12. For the calendar year 1947 and for each thereafter, each licensee shall, as the agent of the Racing Commission, deduct one-half of one per centum of the total amount of money wa-

gered on all races during each and every meeting and remit such deduction to the Commission. All such deductions shall be held in and comprise a fund to be known as the "Racing Fund", and shall be deposited by the Commission in one or more banks or trust companies in the State. The members of the Commission shall have no personal liability for loss to such Fund by reason of the failure or insolvency or other fault of any depository if they shall use ordinary care in the selection of the depository. The Commission shall require any depository to secure by collateral any deposit therein comprising a part or all of the Fund.

The amount of the Racing Fund on hand at any time, representing the deductions made by any particular licensee from the mutuel pool, previously collected by such licensee, as agent of the Commission, may, with the prior written and express permission of the Commission, upon such terms and conditions as it may prescribe, be expended by that particular licensee for any substantial alterations, additions, changes, improvements, or repairs to or upon the property owned or leased by such licensee, and by it used for the conduct of racing. In determining whether to permit the use of any of the Racing Fund, the Commission shall give due consideration to whether its expenditure in each instance will promote the safety, convenience and comfort of the racing public and of horse owners and, generally, whether it will tend towards the improvement of racing in the State. If the deductions, herein provided for, made by any licensee for any calendar year, as

agent of the Commission, shall neither have been spent nor binding commitments have been entered into for their expenditure, with the approval of the Commission, within three (3) years from the last day of the year of collection, the unspent portion of such year's deduction shall revert to the State as part of its general funds, and shall be paid over promptly by the Commission to the Comptroller. *Provided, however,* that due to the present war emergency, such deductions of any licensee for the calendar years 1944, 1945 and 1946 may be expended or binding commitments entered into for its expenditures at any time prior to December 31, 1950.

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